

Sales of “canned” computer software are taxable retail sales in Illinois. Canned software that is purchased via a download over the Internet is taxable as a retail sale. See 86 Ill. Adm. Code 140.141. (This is a GIL.)

August 6, 2004

Dear Xxxxx:

This letter is in response to your letter dated August 11, 2003, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings (“PLRs”) are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department’s regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter (“GIL”) is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings, and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I am writing this letter to clarify the application of Illinois Sales & Use Tax on the products sold by ABC. ABC has always collected & remitted IL sales tax on all the products we sell to customers within Illinois. However, many of our customers have recently argued against the application of sales tax on certain transactions. We would like to request a written ruling from the Illinois Department of Revenue to resolve this issue and avoid further disputes with our customers.

Facts

ABC is a STATE corporation with its headquarters in CITY. The main product ABC sells is basically a network switch or computer server that has been preloaded with a copy of ABC's proprietary management software. Our product is installed into a network of servers and will intelligently manage the workload of these servers so it is evenly distributed and the network or website will run at maximum efficiency.

In addition to these types of products, the customer also has the option to purchase an optional annual maintenance agreement. Generally, these agreements allow customers to download software updates and fixes, provide 24/7 technical support (via telephone,

email, or internet, depending on the product), and a 1-year replacement warranty. If the product malfunctions for any reason and the problem cannot be resolved, the customer only needs to ship the broken unit to ABC and a new replacement unit will be sent to the customer.

ABC has also developed a new method to deliver our management products. Instead of buying a piece of hardware (i.e. switch or server) installed with ABC's proprietary software, customers can now download our software via the Internet to their own server. The customer can download the software anytime, but it must be purchased before they will receive a registration code via email to 'unlock' the software program. Instruction manual will be viewable and available for download over the Internet.

Rulings

Based on the facts described above, we would like to request a ruling on the following Illinois Sales & Use Tax Issues:

1. Does Illinois Sales Tax apply on the sale of Optional Hardware/Software maintenance agreements? ABC currently collects Illinois Sales Tax on these sales as we view the software updates as a taxable single user license of software, not non-taxable multiple user licenses of software.
2. Does Illinois Use Tax need to be self-assessed on each replacement unit shipped to customers under warranty? ABC currently self-assesses Illinois Use Tax on each replacement unit shipped based on the cost of each replacement unit as these are 'additional parts'
3. Does Illinois Sales Tax apply on the software downloaded via the Internet? ABC currently collects Illinois Sales Tax on sales of software downloaded via the Internet as we view this as a single user license of software, not non-taxable multiple user licenses of software.

We would like to confirm that our interpretations of the Illinois rules are correct to avoid further disputes with our customers. Going forward ABC will treat these types of transactions in Illinois as stated above and we would like to get the Department's endorsement as to not result in any unnecessary tax exposure to ABC.

If you have any questions or clarification on the issues detailed above, please do not hesitate to call me.

Department's Response:

Software downloads:

Generally, the sale of "canned" computer software intended for general or repeated use is a taxable retail sale in Illinois. See 86 Ill. Adm. Code 130.1935, enclosed. If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Canned software is considered to be tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means, or other media. Software that is purchased via a download over the Internet, assuming it does not meet the specific requirements of licensed software under Section 130.1935(a)(1), is taxable as a retail sale in Illinois.

Replacement parts under maintenance agreements and maintenance agreements themselves:

In general, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. The taxability of maintenance agreements is dependent upon whether the charge for the agreement is included in the selling price of tangible personal property. If the charge for a maintenance agreement is included in the selling price of tangible personal property, that charge is part of the gross receipts of the retail transaction and is subject to Retailers' Occupation Tax liability (e.g.: manufacturer's warranty). No tax is incurred on the maintenance services or parts when the repair or servicing is completed. See 86 Ill. Adm. Code 140.141(b), enclosed.

If maintenance agreements are sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. See 86 Ill. Adm. code 140.141(c), enclosed. However, when maintenance services or parts are provided under the maintenance agreement, the company providing the maintenance or repair will be acting as a service provider under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when a service provider enters into an agreement to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, the service provider incurs Use Tax based upon its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3), enclosed.

Charges for updates of canned software are considered to be sales of software and fully taxable pursuant to Section 130.1935. Please note that, notwithstanding the previous paragraph, if a maintenance agreement provides for updates of canned software along with hardware, and the charges for the software updates are not separately stated and taxed, then the whole agreement would be taxable as a sale of canned software. In that event, since the entire maintenance agreement is taxed, no tax is incurred on the maintenance services or parts when the repair or

servicing is completed. If, on the other hand, a maintenance agreement provides for updates of canned software along with hardware, and the charges for the software are separately stated and only that portion of the maintenance agreement is taxed, then the service provider incurs Use Tax based upon its cost price of hardware transferred to the customer each time maintenance service is completed.

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Sincerely,

Samuel J. Moore
Associate Counsel

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